

1 UNITED STATES BANKRUPTCY COURT

2 SOUTHERN DISTRICT OF NEW YORK

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4 SECURITIES INVESTOR PROTECTION

5 CORPORATION

6 v.

CASE NO. 08-01789-smb

7 BERNARD L. MADOFF INVESTMENT

8 SECURITIES, LLC, et al,

9 Debtors.

10 - - - - - x

11 IRVING H. PICARD, TRUSTEE FOR THE

12 LIQUIDATION OF

13 v.

CASE NO. 10-05421-smb

14 FRANK J. AVELLINO

15 - - - - - x

16 IRVING H. PICARD, TRUSTEE FOR THE

17 LIQUIDATION OF

18 v.

CASE NO. 11-02732-smb

19 BUREAU OF LABOR INSURANCE

20 - - - - - x

21 U.S. Bankruptcy Court

22 One Bowling Green

23 New York, New York

24 July 29, 2015

25 10:05 AM

1 B E F O R E :

2 HON. STUART M. BERNSTEIN

3 U.S. BANKRUPTCY JUDGE

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5 ECRO: UNKNOWN

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1 HEARING Matter: Madoff Hearing Date

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3 HEARING Matter: Motion to Allow - Trustees Motion and

4 Memorandum to Affirm His Determinations Denying claims of

5 Claimants Holding Interests in Partners Investment Co.,

6 Northeast Investment Club, and Martin R. Harnick & Steven P.

7 Norton, Partners

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9 HEARING Matter: Motion to Dismiss

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11 HEARING Matter: BLI's Motion for Judgment on the Pleadings

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25 Transcribed by: Sheila Orms

1 A P P E A R A N C E S :

2 BAKER HOSTETLER

3 Attorneys for BLMIS and Trustee Irving Picard
4 45 Rockefeller Plaza
5 New York, NY 10111
6

7 BY: KATHRYN M. ZUNNO, ESQ.

8 LAUREN M. HILSHEIMER, ESQ.

9 CATHERINE E. WOLTERING, ESQ.

10 AMY E. VANDERWAL, ESQ.

11 JIMMY FOKAS, ESQ.

12 THOMAS L. LONG, ESQ.

13

14 HAILE SHAW & PFAFFENBERGER

15 Attorneys for Avellino Defendants
16 660 U.S. Highway One
17 Third Floor
18 N. Palm Beach, FL 33408
19

20 BY: GARY WOODFIELD, ESQ.

21

22

23

24

25

1 LOWENSTEIN SANDLER LLP

2 Attorneys for Bureau of Labor Insurance

3 1251 Avenue of the Americas

4 New York, NY 10020

5
6 BY: AMIAD M. KUSHNER, ESQ.

7
8 TELEPHONIC APPEARANCES:

9 KENT COLLIER, REORG RESEARCH, INC.

10 KEVIN H. BELL, SIPC

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1 P R O C E E D I N G S

2 THE COURT: Madoff. Who represents the trustee?

3 MR. FOKAS: Good morning, Your Honor, Jimmy Fokas,
4 Baker Hostetler, and with me, Kathryn Zunno.

5 MS. ZUNNO: Good morning, Your Honor.

6 THE COURT: Why don't we do the motion to allow
7 and confirm trustee's determination first.

8 MR. FOKAS: That's be my colleague, Ms. Vanderwal.

9 MS. VANDERWAL: Good morning, Your Honor.

10 THE COURT: Good morning.

11 MS. VANDERWAL: Your Honor, Amy Vanderwal for the
12 trustee.

13 We're here this morning on the trustee's motion to
14 affirm his determination of the 61 plan, which are filed by
15 claimants who invested in three New York partnerships. The
16 partnerships were the Northeast Investment Club, Partners
17 Investments Co., and Martin R. Harnick and Steven P. Norton,
18 Partners.

19 The investing claimants invested in these
20 partnerships, which invested in turn in BLMIS. They
21 themselves did not have any direct financial relationship
22 with BLMIS. And they did not own the assets that were
23 entrusted to BLMIS for the purposes of trading securities.

24 So the totality of claims as consistent with prior
25 decisions in these proceedings, including the Second

1 Circuit's decision in Kraus (ph) and as well the Second
2 Circuit's (indiscernible) decision.

3 No objections to the relief sought by another
4 trustee have been filed, so unless you have any questions,
5 we would ask that the motion be granted.

6 THE COURT: Is there anyone who wants to be heard
7 in connection with this motion?

8 (No response)

9 THE COURT: The record should reflect there's no
10 response. I'll grant the motion. Claimants are essentially
11 investors in feeder funds, they had no customer accounts
12 with BLMIS. The funds in which they invested had the
13 accounts, and under the decisions of the Second Circuit, the
14 District Court, and this Court, they're not customers within
15 the meaning of SIPA, so their claims will be (indiscernible)
16 the trustee's determination would be allowed. You can
17 submit an order. Thank you.

18 MS. VANDERWAL: Thank you very much, Your Honor.

19 THE COURT: Next up here, the BLI matter.

20 (Pause)

21 THE COURT: Who represents the movant?

22 MR. KUSHNER: Good morning, Your Honor. My name
23 is Amiad Kushner from the Law Firm of Lowenstein Sandler.
24 I'm here with my colleague, Lauren Garcia. We represent
25 Bureau of Labor Insurance.

1 THE COURT: All right.

2 MR. LONG: Good morning, Your Honor, Thomas Long,
3 Baker & Hostetler on behalf of the trustee. Along with me
4 is Catherine Woltering from Baker Hostetler.

5 THE COURT: Good morning.

6 Mr. Kushner, what I'm principally interested in is
7 why I should hear this motion. Stand up.

8 MR. KUSHNER: Sure.

9 THE COURT: You made a motion before Judge
10 Lifland, he denied the motion, you preserved your record for
11 purposes of appeal, so why should I hear the motion? Why
12 should I grant differently?

13 MR. KUSHNER: Well, you have an intervening change
14 in law in that Judge Rakoff issued his decision on what we
15 call the extraterritoriality order. You also have an
16 ongoing process in this court and hundreds of other
17 adversary proceedings, in which the very same issue that we
18 present on this motion is being adjudicated. That is the
19 issue that whether under Section 550 of the Bankruptcy Code,
20 the trustee can void a transfer from a non-U.S. feeder fund
21 to a transferee located outside the United States.

22 THE COURT: But you've litigated that issue. And
23 you lost it. I mean, why shouldn't you just be limited to
24 your appellate rights?

25 MR. KUSHNER: Well, we have the right to file a

1 motion for judgment on the pleadings. It's --

2 THE COURT: But isn't really just a motion for
3 reargument? Judge Rakoff decided the matter differently
4 from Judge Lifland, but wasn't he just exercising the same
5 jurisdiction that Judge Lifland exercised when he decided
6 the motion against you? In other words, why don't they just
7 cool it in the courts?

8 MR. KUSHNER: Well, we've cited cases, Pilgrim's
9 Pride which holds that a decision of a District Court on a
10 motion to withdraw the reference should be considered as the
11 law in the case in the entire bankruptcy proceeding, all
12 adversary proceedings.

13 THE COURT: Well, why wasn't Judge Lifland's
14 decision law of the case, if we take the results in the
15 withdrawn actions?

16 MR. KUSHNER: Well, at that time, in 2012, it was
17 (indiscernible) case. What we've said here is now it's
18 different, now it's 2015, the trustee's conceded to this
19 Court that Rakoff's decision changed the pleading standard
20 under Section 550. You have hundreds of --

21 THE COURT: Certainly in the withdrawn actions.
22 Well, certainly it did, and it's certainly mandatory
23 authority in the withdrawn actions. Because you agree with
24 her, the matter with specific directions to apply the
25 decision. But it's persuasive authority, very persuasive

1 authority, but it's just persuasive authority in all the
2 other matters in this case, isn't it?

3 MR. KUSHNER: We agree that it is persuasive.
4 But, you know, I think separate from the BLI adversary
5 proceeding, you have cases in which the reference was not
6 withdrawn, which are being joined in the extraterritoriality
7 proceedings pending in front of this Court.

8 And as we pointed out in our briefing, the trustee
9 actually took the position on the antecedent debt motion
10 that was pending before this court that even if somebody did
11 not move to withdraw the reference in the district court,
12 the district court decision is the law of the case, and is
13 binding on that party. So BLI is similarly situated. Yes -
14 -

15 THE COURT: But isn't the same thing true of Judge
16 Lifland's decision, it's law of the case?

17 MR. KUSHNER: It was law in the case at that time.
18 But now, you have an intervening change in law. It is no
19 longer the law of the case when you have a higher court
20 changes the law, when you have --

21 THE COURT: But that's the question I have, was it
22 a higher court, or was it simply a court that withdrew the
23 reference and was exercising the same bankruptcy
24 jurisdiction that Judge Lifland exercised when he decided
25 the case?

1 MR. KUSHNER: We would submit that --

2 THE COURT: In other words, it wasn't an appellate
3 court. It wasn't acting as an appellate court.

4 MR. KUSHNER: It clearly was not an appellate
5 court, we acknowledge that in our briefing, but it
6 nevertheless is binding. And the only case that we find
7 that's directly on point, Pilgrim's Pride, addressed what we
8 think is exactly the same situation.

9 You had a district court that decided an issue on
10 a motion to withdraw the reference, and then the bankruptcy
11 court in a separate adversary proceeding treated the
12 district court decision as the law of the case in that
13 separate adversary.

14 THE COURT: Did that decision allow any claimants
15 who had separately litigated the issue about a different
16 result, relitigate that? That's the question I have. I
17 understand the chronology, and I understand what happened,
18 but you litigated this action, you chose not to participate
19 or your client chose not to participate in the withdrawn
20 proceedings. And you litigated it and you lost.

21 MR. KUSHNER: It's correct that --

22 THE COURT: And, yes, there's another case, and
23 maybe there will be another case three months from now from
24 a different district court judge who wrote an appellate
25 decision, I don't know. But how many times do you get to

1 litigate this?

2 MR. KUSHNER: Well, this is only the second time
3 respectfully. And, Your Honor --

4 THE COURT: It sounds like one too many, doesn't
5 it?

6 MR. KUSHNER: It's been three years, and we have -
7 - not only is it an intervening change in law, but you have
8 the trustee conceding that the Rakoff decision changed the
9 law, and you have the specter of inconsistent rulings.

10 THE COURT: Well, we already had that, though.

11 MR. KUSHNER: But now you have the chance to
12 correct that. Now, you have the chance to apply the same
13 rule for the entire bankruptcy case. And as a matter of
14 judicial economy, it just doesn't make sense to have a
15 decision by Judge Lifland stand on this motion, when the
16 Court is simultaneously going to address the exact same
17 issues, and maybe to a different conclusion, and you've just
18 said --

19 THE COURT: So you think it's economical for me to
20 decide your motion and then maybe four or five months from
21 now decide the motion, the bigger motion?

22 MR. KUSHNER: Well, respectfully, Your Honor, you
23 may recall that in November when we were in front of you, we
24 had asked to be joined in that briefing, for that exact
25 reason. We said it's not economical for there to be two

1 different proceedings on the same issue. We asked for
2 permission to be joined in that proceeding. The trustee
3 declined, and that's why we had to bring this motion. We
4 would prefer respectfully to be joined in that process. We
5 do agree that that is the most efficient way to proceed.

6 We don't think it's efficient for you to have to
7 deal with duplicative briefings. We don't think it's
8 efficient for you to deal with the same issue two different
9 cases. So we would respectfully renew our request to be
10 joined in the extraterritoriality briefing that's pending in
11 this court.

12 THE COURT: Let me ask you one other question.
13 There were a lot of facts discussed by Judge Lifland, of
14 course, there was also motion relating to personal
15 jurisdiction, which allowed affidavits to come in. And a
16 lot of those (indiscernible) discussed what I will call
17 (indiscernible) connections, New York and also Fairfield
18 Centuries (ph) connections here. Can I consider that on a
19 motion for judgment on the pleadings?

20 MR. KUSHNER: We would submit you can't, and in
21 fact, we would submit that Judge Lifland considered those
22 facts for purposes of the subject matter jurisdiction issue
23 in that case. It was a completely different legal standard.

24 THE COURT: Well, the only thing he considered the
25 facts on were that the transferred depleting property of the

1 debtor.

2 MR. KUSHNER: Well, let me just clarify. I'm
3 talking about extrinsic facts.

4 THE COURT: I know, yeah, I know.

5 MR. KUSHNER: So the only reason he considered
6 facts outside the pleadings was for purposes of determining
7 whether the bankruptcy court had subject matter
8 jurisdiction. So, no, on this motion, under, you know,
9 12(c) you can't, in our view, look to facts that are not
10 pled, merely because on a separate motion Judge Lifland was
11 faced with the subject matter jurisdiction issue and he
12 looked at facts not in the pleadings. It doesn't mean on
13 this motion, you know, you can look outside the complaints
14 pled. You still have the complaint. They've said to you,
15 they don't want to amend, they're not amending.

16 THE COURT: What they wanted to cure is a motion
17 for summary judgment if I don't dismiss it.

18 MR. KUSHNER: Well, we would contend, it's totally
19 improper to convert this motion to a motion for summary
20 judgment, discovery hasn't even begun. We didn't put in
21 facts outside of the pleadings in our opening brief, just
22 because they improperly submitted hundreds of pages of
23 evidence in opposition to a motion to dismiss doesn't mean
24 you convert it into a motion for summary judgment.

25 So we would submit the proper course is actually

1 to dismiss the complaint. If they want to move to leave to
2 amend now that's the proper course, but they've chosen to
3 stand on their complaint, to the extent Your Honor believes
4 that Judge Rakoff's decision is persuasive, and as a change
5 in law, you should grant our motion. To the extent Your
6 Honor believes it would be more efficient to combine this
7 case, at least for briefing purposes, with the
8 extraterritoriality briefing that's currently pending, we
9 think that's also an efficient way to proceed.

10 But what's not efficient is to deny our motion and
11 to allow a decision that everybody agrees is -- no longer
12 represents the law, just to throw a --

13 THE COURT: I'm not sure the trustee agrees. But
14 we'll hear from the trustee.

15 MR. KUSHNER: Okay.

16 THE COURT: All right. Thanks.

17 MR. LONG: Thank you, Your Honor. When I was
18 preparing for this argument, I decided there were going to
19 be two preliminary issues that we would have to get into
20 before we get to the merits, and the first one was the law
21 of the case issue.

22 THE COURT: Well, it makes no sense to hear the
23 merits twice. So if I'm going to hear the merits, when I
24 hear the omnibus motion.

25 MR. LONG: My point was, Your Honor, dealing with

1 the law of the case. We stand by the arguments set forth in
2 the brief, that clearly Judge Lifland's decision is the law
3 of the case in this particular matter. The law of the case
4 is a doctrine that dictates to courts how to reconsider
5 prior decisions of the court, and there are two elements of
6 it. Obviously you pointed this out, just a moment ago, the
7 counsel for BLI which is that if you have an appellate court
8 that remands, it's mandatory, that the Court follow that.

9 But in this particular instance, there was no
10 remand in this case. So what we have is a situation where
11 this Court has previously ruled, the Court under the law of
12 the case doctrine can reconsider its decision if, in fact,
13 there's been new evidence, there's a clear error, prevent
14 manifest injustice, and if there's a change in the
15 controlling law.

16 Our point, Your Honor, is we stand by the fact
17 that Judge Lifland's decision remains the law of the case,
18 but even if this Court were to consider Judge Rakoff's
19 decision as the new standard, the outcome remains the same.

20 Because if you apply Judge Rakoff's standards to
21 the facts involved in this case, you'll come to the same
22 conclusion that they're not entitled to a dismissal of their
23 complaint.

24 THE COURT: Well, certainly your complaint doesn't
25 plead those facts.

1 MR. LONG: Well, Your Honor, our complaint pleads
2 the following. We not only have the complaint, but we had
3 certain documents that were referenced in the complaint, and
4 that's what I was going to talk about as a second issue.

5 What are the particular pieces of evidence that
6 are to be considered here? Your Honor, fully understand, we
7 have submitted an affidavit, a declaration as part of this
8 procedure to have it converted into a motion for summary
9 judgment. I'll come to that in just a second.

10 Let's go back to the facts considered in the
11 complaint are incorporated by reference. In the complaint,
12 there are references to the subscription agreement, which
13 the Bureau of Labor Insurance executed in order to become a
14 subscriber and shareholder of Fairfield Century.

15 As part of that, the private placement memorandum
16 is part of that subscription agreement. If you look at the
17 terms of the subscription agreement, part of the defined
18 terms you have to reference back to the private placement
19 memo, as well as the fact that they reference the fact that
20 they have read, understood, and that's part of their
21 agreement.

22 In addition, we incorporated by reference the
23 original or I shouldn't say the original, the Fairfield
24 amended complaint in the exhibits attached to it. It is
25 based upon those facts which are all considered under the

1 law to be part of the complaint, the basis for us proceeding
2 in this case.

3 Because if you take into account just that
4 evidence, we have possibly set forth a complaint that allows
5 us to proceed.

6 THE COURT: You're saying it's the issue that's
7 going to be argued in connection with the omnibus motion?

8 MR. LONG: Certainly, Your Honor, if --

9 THE COURT: I assume that your allegations are
10 relevant to Fairfield, are they the same in every one?

11 MR. LONG: I would say this, Your Honor, I was
12 going to move forward on that affidavit that we'd convert
13 this to a motion for summary judgment, and by the way Rule
14 12 --

15 THE COURT: I wouldn't do that today, so.

16 MR. LONG: I --

17 THE COURT: He's entitled to notice and an
18 opportunity to respond.

19 MR. LONG: Well, he was. They did not contest one
20 single --

21 THE COURT: No, no, the Court first has to say
22 that it's going to be treated as a motion for summary
23 judgment, and then they get an opportunity to respond.

24 MR. LONG: My point is, on that affidavit, what we
25 simply have included -- I'm sorry, Your Honor, back in Ohio

1 we call them affidavits, here it's declarations. In that
2 declaration --

3 THE COURT: Well, we have affidavits also.

4 MR. LONG: Yeah. In the declaration, all it does
5 is pretty much supplement the allegations there, by
6 providing BLI's own documents to prove that. There were
7 only minor differences in those facts, such as the fact that
8 Fairfield Century had no offices in the BBI, it had no
9 employees in the BBI, but even in the complaint and the
10 documents attached to it, we make it clear that the FTG
11 Group, which Judge Morero in the Anwar case has held to be a
12 de facto New York partnership, they controlled and operated
13 Fairfield here from New York City.

14 And, in fact, if you look at the original BLMIS
15 customer agreement that was given for Fairfield Century,
16 which again was part of the Fairfield complaint that was
17 referenced -- incorporated by reference, they listed
18 Fairfield Century's address as in the United States, not in
19 the BBI.

20 THE COURT: Can I ask you a question, putting the
21 merits aside? Suppose I agree with you and simply deny the
22 motion because they've had their bite at the apple. And
23 then in the course of determining the omnibus motion, I
24 agree with Judge Rakoff, should they then have the right to
25 come back?

1 MR. LONG: Your Honor, what I'm saying is, even if
2 you agree with Judge Rakoff's standards and apply it in this
3 case as it stands now --

4 THE COURT: Listen, I don't want to hear an
5 argument for summary judgment today because as I said, even
6 if I convert the case, they still have a right to respond.

7 MR. LONG: My point is, Your Honor, I believe
8 there's sufficient evidence without going to that
9 declaration to apply Judge Rakoff's decision in this case
10 and deny the motion.

11 THE COURT: So you want me to decide the motion?

12 MR. LONG: Yes, Your Honor.

13 THE COURT: On the merits?

14 MR. LONG: Yes.

15 THE COURT: All right. Then I'll reserve decision
16 on the motion. I'll probably decide it in connection with
17 the omnibus motion since it's the same issue. All right.

18 MR. LONG: Thank you, Your Honor.

19 THE COURT: Now, I'll hear the motion to dismiss.
20 Who represents the movant?

21 MR. FOKAS: Good morning, Your Honor, Jimmy Fokas,
22 Baker Hostetler, Kathryn Zunno, Baker Hostetler also.

23 MR. WOODFIELD: Good morning, Your Honor, Gary
24 Woodfield from Haile Shaw. I represent what have been
25 referred to as -- collectively as the Avellino defendants.

1 THE COURT: Go ahead, Mr. Woodfield.

2 MR. WOODFIELD: Thank you, Your Honor.

3 Your Honor, our memo and responding memos dealt
4 with a number of issues there. There are only several I'd
5 like to sort of either amplify or clear up this morning in
6 this argument.

7 The first, though, is the most significant
8 argument I believe, and that is our contention that the
9 complaint fails to allege allegations of evidencing actual
10 knowledge.

11 THE COURT: Yeah, but the complaint has several
12 allegations that, I'll say the defendants, there are a lot
13 of defendants, but that the defendants participated with
14 Madoff in the creation of false statements.

15 MR. WOODFIELD: Correct. To deceive the SEC.

16 THE COURT: But they would have had to know that
17 the trades and the holdings depicted in those statements did
18 not reflect actual trades, right?

19 MR. WOODFIELD: In those manufactured statements.

20 THE COURT: So at least as to some of the
21 statements they had, they knew it didn't actually reflect
22 trading securities.

23 MR. WOODFIELD: They knew that those statements
24 that Madoff manufactured for purposes, and taking the facts
25 obviously as true --

1 THE COURT: Right.

2 MR. WOODFIELD: -- in those question, the
3 allegations are egregious in that they permitted and
4 assisted Madoff in creating statements to deceive the SEC to
5 cover a financial shortfall.

6 THE COURT: Now, I realize that doesn't
7 necessarily mean that every -- they knew that every single
8 statement that Madoff produced didn't actually reflect the
9 purchase and sale of securities. But why isn't that enough
10 to survive a motion to dismiss? They at least knew that
11 some of the statements were false.

12 MR. WOODFIELD: Well, those manufactured
13 statements are false and that allegation establishes it.
14 But as we -- I can go on to argue, and of course, Your
15 Honor's intimately familiar with this, having decided Merkin
16 (ph) and comparing the facts I think Merkin 2 and here.

17 THE COURT: But Merkin was never alleged to be a
18 participant in the creation of false financial records. And
19 that's what this complaint alleges, at least in 1992 and,
20 you know, maybe thereafter where (indiscernible) and
21 fraudulent payments, but the compensation, I'll call them
22 the finder's fees are paid through the creation of gold's
23 option trades attributed to certain accounts.

24 MR. WOODFIELD: And there's no clear allegations
25 that Madoff -- I'm sorry, that Avellino had any particular

1 expertise or knowledge in financial transactions, and knew
2 or participated in the generation of those trades.

3 Other than -- and Your Honor obviously hit on the
4 most significant issue, and that is, these manufactured
5 statements. But if you go through all the other allegations
6 and compare them to the Merkin allegations, they don't stand
7 up. Everything else, I mean, the fact that thereafter,
8 after they were shut down in '92 that they invested,
9 continued to invest with Madoff, two closely held family
10 businesses that were created for estate planning purposes is
11 just as plausible as some other deception that they're
12 attempting to attribute to those.

13 Your Honor's reference to the fact that they
14 referred to the fact that Avellino referred A and B clients
15 who wanted to continue to invest, for which they received,
16 plaintiff sensationalizes those as fraudulent side payments,
17 and Your Honor's I think more accurate description is
18 referral fees, and that's what they are.

19 Again, those kinds of acts don't evidence the
20 actual knowledge that Avellino had that Madoff was
21 participating in a Ponzi scheme. And again, the specific
22 allegations that Your Honor found in Merkin of specific
23 conduct of Merkin, other than just generic -- here's an
24 example.

25 Your Honor ticked off in Merkin several facts that

1 evidenced the close personal relationship, and they were
2 specific facts, not just a generic, they had a close
3 personal relationship.

4 Here, we have nothing other than a one generic
5 reference in paragraph 119 that says, "Avellino Corp enjoyed
6 direct access." There isn't anything else evidencing the
7 close personal relationship.

8 And again, in Merkin, you've got specific --

9 THE COURT: Wasn't one of these guys a partner of
10 Madoff's father?

11 MR. WOODFIELD: In an accounting firm. No, in
12 Madoff's wife's father, Ruth, yes, he graduated from City
13 College and went to work in the accounting firm.

14 THE COURT: And he worked at their office, right?

15 MR. WOODFIELD: Sorry?

16 THE COURT: Madoff worked out of their office?

17 MR. WOODFIELD: For a short period of time when he
18 started his business, he started in their office, yes.

19 But again, the contrast I draw is the fact that in
20 Merkin you've got specific instances, such as Merkin was
21 told by one of his money managers that couldn't possibly
22 exist, and he made specific references. And he had
23 documents in his possession that attributed actual knowledge
24 on behalf of Merkin. And those same kind of allegations in
25 a more generic form are here. But as Your Honor and other

1 courts have found, those kinds of facts, such as lack of
2 transparency and consistent returns, you know, should have
3 raised some duty to investigate.

4 THE COURT: Well, his returns weren't only
5 consistent, he was pre-promised 17 percent returns. How do
6 you do that?

7 MR. WOODFIELD: Promised a return --

8 THE COURT: Of 17 percent.

9 MR. WOODFIELD: -- and then thereafter reduced
10 out, because that was the referral fee that he was receiving
11 for having put the A & B customer into Madoff.

12 THE COURT: I thought this was on their own
13 investments, the 17 percent.

14 MR. WOODFIELD: The 17 percent constituted the
15 referral that they were receiving.

16 THE COURT: Oh, all right.

17 MR. WOODFIELD: Your Honor, I can go through this
18 point, obviously you're well versed in it. I do see a
19 dramatic contrast between the facts here and the facts in
20 Merkin. Again, the only significant fact I see here is the
21 -- as Your Honor indicated, the clear participation in
22 generating false statements for purposes of deceiving the
23 SEC. I contend that that standing alone does not evidence
24 actual knowledge of a Ponzi scheme.

25 Your Honor, just several of the points I'd just

1 like to --

2 THE COURT: Does it have to be a Ponzi scheme, or
3 just knowledge the securities weren't being traded? I know
4 that we've used shorthand methods to refer to a lot of this,
5 but the essence of the safe harbor was that, you know,
6 securities aren't being traded.

7 MR. WOODFIELD: Well, the cases are all over the
8 place on that, and I think the allegations are that this is
9 a Ponzi scheme. I think the actual knowledge has to be --

10 THE COURT: Well, Madoff admitted to that in his
11 allocution.

12 MR. WOODFIELD: Yeah, but my client hasn't.

13 THE COURT: Well, okay. You can try that issue.

14 MR. WOODFIELD: I'd rather not.

15 THE COURT: Okay.

16 MR. WOODFIELD: That's why I'm here.

17 THE COURT: Okay.

18 MR. WOODFIELD: Judge, just several other points
19 if I may touch upon that I think -- well, two of them got
20 somewhat muddled in our briefing, and I'd like to just clear
21 up --

22 THE COURT: Can I ask you a question?

23 MR. WOODFIELD: Please.

24 THE COURT: Do you think the trustee has alleged
25 enough to allege willful blindness?

1 MR. WOODFIELD: Well, I hate to ever make an
2 admission, but if I compare it to Merkin, I believe that is
3 the case.

4 THE COURT: Okay. So at a minimum, the trustee's
5 entitled to recover the two year fraudulent or potential
6 fraudulent transfers, or at least it's perceived, not
7 necessarily recovered. I understand you may have --

8 MR. WOODFIELD: That's Your Honor's -- yes, I mean
9 if Your Honor is going to be consistent in your findings --

10 THE COURT: Well --

11 MR. WOODFIELD: -- as in Merkin --

12 THE COURT: -- there's something to be consistent.

13 MR. WOODFIELD: Well, I'm not urging you to do
14 that.

15 THE COURT: Even if it's foolish consistency,
16 right?

17 MR. WOODFIELD: Well, I wasn't going to say that,
18 Your Honor.

19 THE COURT: All right. Well, I said it, so you
20 don't have to.

21 MR. WOODFIELD: Your Honor, may I just touch on a
22 couple of other points?

23 THE COURT: Sure.

24 MR. WOODFIELD: One, like you say, I think the
25 briefs got somewhat muddled on issues of piercing the

1 corporate veil and imputing knowledge. I mean --

2 THE COURT: I didn't understand one of your
3 implication arguments. I understand you're saying you --
4 from one agent to another, but my understanding of the
5 trustee's argument is, that those -- the individual
6 implication issues were a principal agent issue, not an
7 agent/agent issue, that in other words, that Avellino was
8 acting for I guess Ms. Avellino, and they weren't co-agents,
9 she was essentially the principal and he was her agent.

10 MR. WOODFIELD: And I don't believe there's
11 sufficient facts to evidence that agent relationship. But
12 backing up just a second, I think there's not a dispute as
13 to the law, I don't believe, but I think it, as I say, got
14 somewhat muddled in the brief. And that is, I believe the
15 complaint is riddled with allegations of imputing knowledge
16 and piercing the corporate veil.

17 The points I wanted to make with regard to
18 imputation is, sure, we don't dispute the fact that a
19 corporation can only act through its agents or officers and
20 consequently you can impute knowledge to the corporation.
21 But you can't impute knowledge to the principals or non-
22 owners of that entity, and I believe the complaint has that
23 throughout.

24 THE COURT: Well, what about if the non-owners are
25 the principals?

1 MR. WOODFIELD: Well, they may be liable on --
2 assuming there's a general partnership, let's say, and
3 they're jointly and severally liable for the obligations of
4 the partnership, they may have exposure on another theory.
5 But you can't impute the knowledge from an individual to
6 other individuals who are not owners of that entity.

7 THE COURT: Okay. You were going to talk about
8 piercing the corporate veil?

9 MR. WOODFIELD: Well, again, yes, just on that
10 point, Judge. Our point is, again it's somewhat similar to
11 the imputation. That is, you can't impose -- if you pierce
12 the corporate veil, you can't impose liability on others
13 than that entity, any other individuals, other than the
14 owners of that entity. And again, I think the way the
15 complaint is read, they're making that argument, although
16 it's hard to tell because it's combined quite often with
17 various allegations of agency relationship.

18 But, you know, a legal entity can be held liable
19 under piercing the corporate veil, or the principals of an
20 entity, but not others. The only other point I want to
21 touch on, Judge, and it's a point that you raised in your
22 June 2nd decision, and that is with regard to the subsequent
23 transfer claim. And here, as Your Honor sue sponte
24 recognized there, those -- that complaint is defective
25 because it alleges both direct -- that the subsequent

1 transfers were made directly to or for the benefit of, and
2 that's clearly a defect that needs to be corrected.

3 Do you have any questions of me, Your Honor?

4 THE COURT: No, thank you.

5 MR. WOODFIELD: Thank you.

6 MR. FOKAS: Good morning, Your Honor.

7 THE COURT: Good morning.

8 MR. FOKAS: I think Your Honor seized exactly on
9 what the issue is here and the facts that's alleged in this
10 complaint show, that these defendants, Avellino, Bienes
11 (ph), Thomas Avellino knew that there were no securities
12 transactions. And why did they know that --

13 THE COURT: At least with respect to the ill-
14 advised statements.

15 MR. FOKAS: That's right. And let's talk about
16 those advised statements. There's really two instances in
17 1992, where there were revised statements. There was the
18 initial instance when internal records of BLMIS did not
19 match the records of Avellino and Bienes and revealed a \$50
20 million shortfall.

21 Their response to that, and the response to the
22 SEC was about to take Avellino and Bienes' testimony was to
23 create the phony, what we call the A&B IA account. In fact,
24 they -- three years of fictitious account history that, you
25 know, in no way, shape or form could represent any

1 legitimate securities transactions.

2 Thereafter, Avellino and Bienes testified to the
3 value of their accounts. It was consistent with what was on
4 these revised statements that had these transactions. But
5 it didn't end there. Not more than a month later, as the
6 SEC and the court appointed receiver continued to press for
7 more information from Avellino and Bienes, and as we allege
8 in the complaint, Madoff realized that there were going to
9 be other shortfalls revealed in other years, in other
10 statements.

11 So what was the response to that? The response
12 then was to ask Avellino and Bienes to return their
13 historical account statements, to return. And that's what
14 we alleged in great level of detail in the amended
15 complaint, that Avellino and Bienes actually did. They went
16 back, they gathered up the account statements for at least a
17 three year period, returned those back to Madoff, who then,
18 you know, magically created a new set of account statements
19 that closed the shortfalls in the prior years, and continued
20 to fall.

21 And so we, based on these allegations, Your Honor,
22 there really is no other plausible inference that should be
23 drawn at this stage of the proceeding, other than that they
24 knew there were no securities transactions, they knew they
25 were not receiving transfers in connection with securities

1 contracts, and they're not entitled to the 546(e) safe
2 harbor.

3 And, you know, one other point to be made is,
4 beyond their actual participation in what we allege to be a
5 conspiracy with Madoff to conceal this, they also provided
6 internal accounting records, to make the job a little easier
7 for Mr. Madoff to create these backdated statements.

8 And what they did was, they provided as we allege
9 in the complaint, ledgers, general ledgers that revealed
10 what the balances were on the Avellino and Bienes, the
11 accounting firm, the Peter (ph) Funds records. And provided
12 those, so that the statements could match. So the story
13 that was going to be told to the SEC and that was told to
14 the SEC at that time, and the court appointed receiver was
15 consistent with sufficient assets being on hand, and that
16 there was a broker who was actually conducting securities
17 transactions.

18 There's just simply no way and no good reason for
19 your broker, your purportedly legitimate broker to ask you
20 to return your historical account statements, and replace
21 them with different transactions that purported to occur
22 many years earlier.

23 And the last thing we allege on that point, Your
24 Honor, in the complaint, is that the exact documents that
25 were produced to the court-appointed receiver and to the SEC

1 were at least three years of revised statements that Madoff
2 concocted after Avellino and Bienes returned those
3 statements back to them.

4 So putting this altogether in that time period,
5 leads you to the conclusion at this stage, again at the
6 pleading that it had to have known that there were no actual
7 securities transactions, and therefore, they have the actual
8 knowledge and the trustee has alleged sufficiently at this
9 stage that they had the actual knowledge of that, denies
10 them the safe harbor of Section 546(e).

11 And, you know, talking about what Your Honor's
12 referred to as the finder's fees, and what we, the trustee,
13 referred to as fraudulent side payments, there we used that
14 term just to highlight the blatantly fraudulent --

15 THE COURT: I know why you used the term.

16 MR. FOKAS: Right. Well then, you'll save me a
17 few sentences. But there, is yet another example of why,
18 you know, we believed these defendants had actual knowledge.

19 THE COURT: That's why your complaint is 145 pages
20 I guess.

21 MR. FOKAS: Well, the exhibits -- we -- you know,
22 while it may not be a short statement, Your Honor, we hope
23 it's plain.

24 THE COURT: I can't agree with you on that one,
25 Mr. Kushner.

1 MR. FOKAS: Well, but the point being that, you
2 know, these are -- you can't unlearn actual knowledge. So
3 the moment they knew there were no securities transactions,
4 they can't go back, and then say, well, these were finder's
5 fees and the way they were paid were -- made no difference
6 to us. Again, it just compounds that.

7 Years after, it continued, and they knew that
8 there were no securities transaction. They're not entitled
9 to the safe harbor, and we believe that the plaintiffs
10 allege to the applicable standard.

11 THE COURT: I have a question that was raised in
12 the movant's papers, the entity that's the subject with the
13 SIPA proceeding came into being in 2000. I'm going to ask a
14 different question than you think I'm going to ask you.

15 Assuming you can get past the statute of
16 limitations problems, you're seeking to recover transfers
17 made by an entity that is not the subject of the SIPA
18 proceeding. How can you do that?

19 MR. FOKAS: Well, I think as Your Honor's, you
20 know, previously decided and recently in the omnibus good
21 faith decision and was decided in the inter-account
22 (indiscernible) decision, I think where there's really no
23 distinction between the two entities.

24 THE COURT: But that was for purposes, at least
25 the inter account transfer, it was for the purposes of

1 computing net equity, and in the more recent decision for
2 the purposes of computing potential liability I guess. But
3 you're actually seeking to recover transfers at this point,
4 made by an entity that's not an entity -- that's not the
5 entity which is the debtor in the SIPA proceeding. Isn't
6 Mr. Picard limited to recovering the transfers by the entity
7 that's the entity in the SIPA proceeding?

8 MR. FOKAS: And I think they're essentially one in
9 the same. The change in business form did not change the
10 underlying membership in SIPA. In SIPC, that BLMIS was a
11 member of since 1970. And it's that membership that allows
12 that and forces that SIPA to apply, and once SIPA applies,
13 you'll have -- the trustee has all the authority and power
14 under SIPA to avoid and recover those transfers.

15 And we think it would be almost arbitrary at that
16 point, where the fraudster decided to change from the sole
17 proprietorship to an LLC to somehow foreclose the trustee's
18 ability to recover those transfers.

19 THE COURT: Is there any SIPC case law on that
20 point?

21 MR. FOKAS: Your Honor, I don't believe there's --
22 the case law we rely on is primarily how this decision --
23 how this issue's been decided in the --

24 THE COURT: How about bankruptcy case law, where a
25 trustee can go and recover non-debtor property -- transfers

1 that not what appears to be non-debtor property on the
2 theory that the non-debtor was really under some theory an
3 alter ego of the debtor.

4 Is there any authority to that proposition?

5 MR. FOKAS: Your Honor, I'm not familiar with any
6 authority on that position.

7 THE COURT: All right.

8 MR. FOKAS: And just if I can make just a couple
9 of more points on the -- you know, on the imputation issue
10 that counsel raised.

11 It's just -- imputation here is pretty simple,
12 Your Honor. It's most of the entities and just about all of
13 the entities that held BIA accounts here at issue were
14 general partnerships. We've alleged that Avellino and
15 Bienes and in some instances, Thomas Avellino were general
16 partners of those entities, and therefore, they were acting
17 on -- when they acted on behalf of those general
18 partnerships, their actual knowledge is imputed to the
19 general partnership.

20 I think it's a separate issue, whether you can
21 impute to the individual partners, I think you can. I think
22 there's no difference there, but on that issue it's really
23 simple. With respect to individual imputation, in the few
24 instances where that happens, where there was individual
25 accounts, and I believe there was one account for Diane

1 Bienes, Mr. Bienes' wife, we've adequately alleged there
2 that Mr. Bienes and Mr. Avellino also acted as an agent, in
3 that sense, as Your Honor noted, it's just a simple agent
4 acting on behalf of an individual principal where they
5 controlled the account, they made the decisions, they opened
6 the account, they made decisions on financing the account,
7 withdrawing the money, so on and so forth.

8 So there's really no basis to depart. It's pretty
9 black letter law that the, you know, the actions of a
10 partner imputed to a partnership.

11 And the last point on veil piercing that counsel
12 raised, I think it did get a little -- it may have gotten a
13 little muddled in the brief, but again I think this is very
14 simple here.

15 We've alleged that all the entity defendants that
16 held BIA accounts were general partners, or a de facto
17 general partnership. And so in term, veil piercing is
18 treated liability here, quote individuals liable, which you
19 know, assuming we've avoided the transfer at issue, you
20 know, it becomes an issue for recovery of those transfers.

21 And we think we've alleged, to the extent we need
22 to, pled in the alternative primarily to the extent it's
23 required, that we've met all the factors you need and it's
24 sufficiently alleged to pierce the veil to the extent we
25 need to. We don't believe that we will, since these are

1 general partnerships if we proceed to that
2 level.

3 And one last thing, I promise this is the last
4 point on willful blindness that Your Honor --

5 THE COURT: Well, he's conceded it, so you --

6 MR. FOKAS: Right, he's conceded --

7 THE COURT: You can sit down at this point.

8 MR. FOKAS: It's just that there's \$17 million at
9 issue on the two years.

10 THE COURT: Okay. Thank you.

11 MR. WOODFIELD: I have nothing further, thank you.

12 THE COURT: I'll reserve decision. I'll -- I'd be
13 curious if there's any authority on the issue I raised about
14 the ability to recover transfers by an ostensible non-debtor
15 under some theory of alter ego, which I assume -- I'm
16 assuming, that Mr. Picard has at least the same rights as a
17 trustee in that respect.

18 So I'll give you two weeks to provide, you can do
19 it in the form of letter briefs, short memoranda on that
20 issue. If you can find SIPC cases, fine, but I guess
21 general bankruptcy cases are also relevant.

22 MR. FOKAS: Thank you, Your Honor.

23 THE COURT: Thank you very much. Have a good
24 trip.

25 UNIDENTIFIED: Thank you, Your Honor.

1 (Proceedings concluded at 10:47 AM)

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CERTIFICATE

I, Sheila G. Orms, certify that the foregoing is a true and accurate transcript from the official electronic sound recording.

Sheila Orms

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DN: cn=Sheila Orms, o, ou,
email=digital1@veritext.com, c=US
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SHEILA ORMS, APPROVED TRANSCRIBER

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Veritext Legal Solutions

330 Old Country Road

Suite 300

Mineola, NY 11501